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No. 97-868

IN THE
Supreme Court of the United States
OCTOBER TERM, 1997

NACCO INDUSTRIES, INC.,
Petitioner,
v.
ROGER W. TRACY, TAX COMMISSIONER OF OHIO,
Respondent.

On Petition for a Writ of Certiorari to the Supreme Court of Ohio

MOTION FOR LEAVE TO FILE BRIEF *AMICUS CURIAE* AND BRIEF OF COMMITTEE ON STATE TAXATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

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MOTION FOR LEAVE TO FILE BRIEF *AMICUS CURIAE*

The Committee On State Taxation ("COST") respectfully requests leave to file a Brief as *Amicus Curiae* in support of Petitioner. The interest of COST as *amicus curiae* is described *infra* at Brief, pp. 2. Counsel for Petitioner has consented to COST's filing of an *amicus* brief. Despite COST's qualifications to submit an *amicus* brief, Counsel for Respondent has refused to consent to the filing of such a brief. However, in the absence of such permission there are at least two reasons for granting this request.

First, with respect to the Petition filed in this case, COST has additional observations to make concerning the constitutional and federal statutory implications of the interpretation of the intergovernmental tax immunity doc-

trine that has been set out by the Ohio Supreme Court in this case. A full exposition of the controversy of this case by interested and eligible *amicus* is ultimately to the benefit of the Court in its administration of writs for certiorari.

Second, because NACCO Industries, Inc. is but one of numerous COST members that are required to file returns in jurisdictions that have made conflicting interpretations of the intergovernmental tax immunity doctrine, COST is uniquely qualified to comment on the Ohio court's refusal to follow this Court's mandate to interpret the intergovernmental tax immunity doctrine as a prohibition against discrimination. *Compare Memphis Bank & Trust Co. v. Garner,* 459 U.S. 392 (1983) *with Doneski v. Comptroller of the Treasury,* 605 A.2d 649 (Md. Ct. Spec. App. 1992), *cert. denied,* 506 U.S. 1054 (1993).

Respectfully submitted,

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December 22, 1997

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BRIEF OF COMMITTEE ON STATE TAXATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

INTRODUCTORY STATEMENT

This brief is submitted by the Committee On State Taxation as *amicus curiae* in support of the Petitioner in the above-captioned matter.*

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* No Counsel for a party authored this brief in whole or in part, and no person or entity other than *amicus curiae*, its members or counsel, has made a monetary contribution to the preparation or submission of this brief. NACCO Industries, Inc., a COST member, has reimbursed COST for printing expenses associated with preparing this *amicus curiae* brief.

INTEREST OF *AMICUS CURIAE*

The Committee On State Taxation ("COST") is a non-profit trade association that was organized in 1969 as an advisory committee to the Council of State Chambers of Commerce. COST, which was separately incorporated on January 1, 1992, has a membership of over 460 multistate corporations, including NACCO Industries, Inc., engaged in interstate and international commerce. COST's objective is to preserve and promote equitable and nondiscriminatory state and local taxation of multi-jurisdictional business entities.

Many of COST's members are engaged in business in the State of Ohio, and thus have a particular interest in the ultimate resolution of the method by which the Ohio corporate franchise tax is calculated and imposed. Further, the Ohio Supreme Court's narrow interpretation of the intergovernmental immunity doctrine is contrary to the position of at least one other State, forcing many COST members to take inconsistent tax return filing positions. *See, Doneski v. Comptroller of the Treasury,* 605 A.2d 649 (Md. 1992) *cert. denied,* 506 U.S. 1054 (1993). Therefore, COST has an interest in this case.

SUMMARY OF ARGUMENT

The Ohio Supreme Court's interpretations of both 31 U.S.C. Section 3124 and the constitutional intergovernmental tax immunity doctrine are inconsistent with this Court's decisions. The Ohio court found that the State's discriminatory taxation of the gain on the sale of federal obligations does not violate the statutory and constitutional intergovernmental tax immunity doctrines. However, this Court has made clear that such discrimination is unconstitutional. *Memphis Bank & Trust Co. v. Garner,* 459 U.S. 392 (1983). Further, holders of federal property are entitled to the doctrine's protection from discrimination. *United States v. Fresno,* 429 U.S. 452, 462 (1977).

The Ohio court, in applying the intergovernmental tax immunity doctrine, distinguished gains on federal instruments and interest earned on federal instruments and found that gains fall outside the constitutional and statutory doctrines. However, the predecessor to 31 U.S.C. Section 3124 has been construed as a "broad exemption of federal obligations from state and local taxation." *Memphis,* 459 U.S. at 395. Thus, the Ohio court's interpretation of the intergovernmental tax immunity doctrine represents another instance of a State's "hypertechnical reading of the nondiscrimination clause." *See Davis v. Michigan Dep't of Treasury,* 489 U.S. 803, 809 (1989).

ARGUMENT

THE OHIO FRANCHISE TAX DISCRIMINATES AGAINST HOLDERS OF FEDERAL INSTRUMENTS AND THEREFORE THE TAX VIOLATES THE INTERGOVERNMENTAL TAX IMMUNITY DOCTRINE AND 31 U.S.C. SECTION 3124.

The scope of the intergovernmental tax immunity doctrine has evolved over the years. However, this Court has made clear that "there has been no departure from the principle that state taxes are constitutionally invalid if they discriminate against the [Federal] Government." *Memphis Bank & Trust Co. v. Garner,* 459 U.S. 392, 397 n.7 (1983). Further, this Court has held that "[t]he State's interest in adopting the discriminatory tax, no matter how substantial, is simply irrelevant to an inquiry into the nature of the two classes receiving inconsistent treatment," *Davis v. Michigan,* 489 U.S. 803, 816 (1989). And, "it does not follow that private entities or individuals who are subjected to discriminatory taxation on account of their dealings with a sovereign cannot themselves receive the protection of the constitutional doctrine. Indeed, all precedent is to the contrary." *Id.* at 814.

31 U.S.C. Section 3124 exempts from state and local taxation stocks and obligations of the United States. The provision does provide, however, that state and local gov-

ernments may impose a nondiscriminatory franchise or other nonproperty tax on federal obligations. 31 U.S.C. Section 3124(a)(1). In interpreting the statutory meaning of "nondiscrimination," this Court has found that the statute is "principally a restatement of the constitutional rule." *Memphis Bank & Trust v. Garner*, 459 U.S. at 396-97. Nevertheless, the Ohio Supreme Court held that 31 U.S.C. Section 3124 does not apply to gain derived from the sale of federal instruments and therefore the existence of discrimination is irrelevant: "Ohio's franchise tax is valid, *regardless of whether it is discriminatory*." *NACCO Industries, Inc. v. Tracy*, 681 N.E.2d 900, 905 (Ohio 1997) (emphasis added). The Ohio court reasoned that the intent of 31 U.S.C. Section 3124 is to immunize from state taxation only the federal obligation or interest on the obligation, and not gains from the sale of federal obligations. *Id.* at 904. Thus, because gains on the sale of federal instruments are not expressly mentioned in 31 U.S.C. Section 3124, the Court concluded that gains on the sale of federal instruments fall outside the scope of the statute.

The Ohio court extended its reading of 31 U.S.C. Section 3124 in construing the constitutional intergovernmental tax immunity doctrine. The court reasoned that under the constitutional doctrine, a franchise tax must be nondiscriminatory unless "Congress has declared otherwise." *Id.* at 905, *relying on United States v. Fresno*, 429 U.S. 452, 460 (1977). Not surprisingly, the court found that U.S.C. Section 3124 is an indication of Congress's intent to immunize from state taxation only the federal obligation or the interest on it. *Id.* at 904. Thus, the court used its interpretation of 31 U.S.C. Section 3124 to dramatically limit the reach of both the statutory and constitutional intergovernmental tax immunity doctrines.

The Ohio Supreme Court's reliance on *United States v. Fresno* is misplaced. In *Fresno*, this Court decided that the intergovernmental tax immunity clause may apply to

a property tax levied on federal employees on their possessory interests in housing owned and supplied to them by the Federal Government. 429 U.S. at 453.[1] Therefore, 31 U.S.C. Section 3124 was not relevant and was not discussed nor interpreted by the *Fresno* Court. Because the Ohio Supreme Court interpreted 31 U.S.C. Section 3124 to undermine the statutory and the constitutional intergovernmental tax immunity doctrine, the court's reliance on *Fresno* is without merit.

The Ohio court's narrow interpretation of the intergovernmental tax immunity doctrine runs contrary to this Court's prior decisions construing the statutory and constitutional intergovernmental tax immunity doctrines. In *Memphis Bank & Trust Co. v. Garner,* the Court was faced with deciding "whether the Tennessee bank tax violates the immunity of obligations of the United States from state and local taxation." 459 U.S. 392, 393 (1983). In interpreting the predecessor to 31 U.S.C. Section 3124, the Court found that "Title 31 U.S.C. Section 742 establishes a broad exemption of federal obligations from state and local taxation," 459 U.S. at 395. Thus, the lower court's finding that the interest on federal obligations is protected from discriminatory taxation, while gain on the sale of federal obligations is not, violates the Court's mandate of construing the exemption in a broad manner.

The *Memphis* decision is one of many instances where this Court has broadly interpreted the intergovernmental tax immunity doctrine. In *American Bank & Trust Co. v. Dallas,* the Court noted that an earlier version of 31 U.S.C. Section 3124 "is sweeping: with specific exceptions, it 'extends to every form of taxation that would re-

[1] The Court concluded that "[t]he tax can be invalidated, then, only if it discriminates against the [Federal Government] or other federal employees, which it does not do. *Id.* at 464. Thus, it is noteworthy that the Court's inquiry required a determination as to whether the state tax discriminated against the federal government or its employees.

quire that either the obligations or the interest thereon, or both, be considered, directly or indirectly, in the computation of the tax." 463 U.S. 855, 862 (1983) *relying on Memphis Bank and Trust Co. v. Garner*, 459 U.S. 392, 395-96 (1983).

While this Court has viewed the doctrine as a broad exemption from state taxation, it is unrealistic for the Court to provide guidance on every conceivable application of the doctrine. Thus, in *Davis v. Michigan Dep't of Treasury*, 489 U.S. 803 (1989), the Court struck down a State's attempt to impose a discriminatory tax on the retirement benefits paid to federal retirees. The Court found that "[i]t is difficult to imagine that Congress consented to discriminatory taxation of the pensions of retired federal civil servants while refusing to permit taxation of current employees, and nothing in the statutory language or even the legislative history suggests this result." *Id.* at 810. Similarly, this Court has not had the opportunity to decide whether gains on the sale of federal instruments are constitutionally and statutorily permitted to be subjected to a discriminatory state tax, while interest on federal obligations is undoubtedly protected from such taxes. However, just as the doctrine protects the income of current employees *and* the correlative income of retired employees, the interest income from federal obligations *and* the correlative gain on the sale of federal obligations should be afforded equivalent protections.

The Ohio court found that the gain on the sale of a federal instrument "does not arise directly from the relationship between the taxpayer and the federal government. . . . We find this relationship too attenuated to invalidate the Ohio franchise tax." *NACCO*, 681 N.E.2d at 905-6. In *Memphis Bank*, the Court stated that a "tax does not violate the constitutional immunity if it does not discriminate against *holders* of federal property or those with whom the Federal Government deals." 459 U.S. at 397, (emphasis added). *See, also United States v. Fresno*, 429

U.S. 452, 462 (1977). ("A state tax that imposes a greater burden on holders of federal property than on holders of similar state property impermissibly discriminates against federal obligations."). The Ohio court's determination that the gain generated by the sale of a federal instrument by a holder of federal property falls outside of the intergovernmental tax immunity doctrine is inconsistent with this Court's prior rulings finding that owners of federal property are protected from discriminatory taxation on the ownership of federal instruments.

Finally, the Ohio court posits that because gains and losses on the sale of state instruments are not included within the Ohio franchise tax base, there is no evidence that the scheme discriminates against holders of federal instruments. *NACCO*, 681 N.E.2d at 905. The Ohio court's analysis misses the mark—the discrimination results from the fact that gains on the sale of federal obligations are taxable while gains from Ohio obligations are not. The discrimination exists at the time the instrument is purchased, and therefore, dissuades investors from purchasing federal instruments.[2] Clearly, this discrimination places holders of federal bonds at a disadvantage. The taxpayer in the present case fell victim to such discrimination and paid a higher Ohio tax than had the taxpayer sold an equivalent Ohio bond at a gain. The fact that a taxpayer could receive favorable tax treatment on the loss sale of a federal instrument vis-a-vis an Ohio instrument is irrelevant and should not save the discriminatory taxing scheme from being stricken.

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[2] As a general matter, investors make investment decisions with the intent to earn a profit. Therefore, the lower court's self serving suggestion that the disallowance of losses from State obligations negates the discriminatory treatment of gains is illusory. In *Doneski v. Comptroller of the Treasury*, 605 A.2d 649 (Md. 1992), *cert. denied*, 506 U.S. 1054, the court held that "Maryland's taxation scheme . . . impermissibly discriminates against holders of federal obligations by diminishing the investment attractiveness of the United States obligations in favor of state obligations." *Id.* at 653.

CONCLUSION

For the reasons set forth above, the Committee On State Taxation respectfully requests that the Court grant a writ of certiorari and reverse the decision of the Supreme Court of Ohio.

Respectfully submitted,

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